

Franchise Tax Board**ANALYSIS OF ORIGINAL BILL**

Author: Harman Analyst: Scott McFarlane Bill Number: SBX1 11
Related Bills: See Legislative History Telephone: 845-6075 Introduced Date: October 11, 2007
Attorney: Tommy Leung Sponsor: _____

SUBJECT: Employer Provided Health Insurance Credit / Franchise Tax Board To Report To Legislature On Or Before September 12, 2012, On Usage Of Credit

SUMMARY

This bill would create a tax credit for taxpayers that provide qualified health insurance for their employees.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to help small businesses make contributions to their employee's Health Savings Accounts (HSA) in a cost effective way.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2008, and before January 1, 2014.

POSITION

Pending.

Summary of Suggested Amendments

Amendments 1 and 2 have been provided to clarify the definition of "qualified taxpayer."
Amendment 3 would resolve a technical error.

ANALYSISFEDERAL LAWEmployer Deductions

Existing federal law allows ordinary and necessary business expenses to be deducted, including health care coverage premiums paid by an employer for accident or health plans for employees.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Selvi Stanislaus

11/28/07

Existing federal law also allows self-employed persons to deduct from gross income 100% of amounts paid for health insurance for themselves, spouses, and dependents.

Employee Exclusion from Gross Income

The amount of an employer's contribution, including any salary reduction contribution made through a cafeteria plan, to an accident or health plan for the benefit of an employee or the employee's spouse or dependents is excluded from the employee's gross income.

Health Savings Account Defined

Under federal law, a health savings account (HSA) means a trust created or organized in the United States as a health savings account exclusively for the purpose of paying the qualified medical expenses of the account beneficiary. HSAs are available to individuals who are covered under a high deductible health plan (HDHP) and are not covered under any other health plan that is not a high deductible plan.

High Deductible Health Plan Defined

Under federal law, an HDHP has:

- A higher annual deductible than typical health plans, and
- A maximum limit on the sum of the annual deductible and out-of-pocket medical expenses that you must pay for covered expenses. Out-of-pocket expenses include co-payments and other amounts, but do not include premiums.

Medical Savings Account (MSA) Defined

Under federal law, an Archer MSA is a tax-exempt trust or custodial account that is established with a U.S. financial institution (such as a bank or an insurance company) in which money is saved exclusively for future medical expenses.

A Medicare Advantage MSA is an Archer MSA designated by Medicare to be used solely to pay the qualified medical expenses of the account holder who is eligible for Medicare.

CALIFORNIA LAW

Current state law does not provide a tax credit for health care costs. For tax years beginning on or after January 1, 1997, California conformed to the federal provisions for MSAs, and the law is generally the same. California does not conform to any of the federal HSA provisions, including the tax-free rollover from an MSA to an HSA.

Employer Deductions

California law conforms to the federal rules relating to ordinary and necessary expense deductions, such as employee wages paid and self-employed health insurance.

Employee Adjustments to Federal Adjusted Gross Income

The California personal income tax return starts with federal adjusted gross income (AGI) and requires adjustments to be made for differences between federal and California law.

THIS BILL

This bill would allow a 15% credit for amounts paid or incurred during the taxable year by a qualified taxpayer that provides qualified health insurance for its employees who perform services in California. The credit would be available for taxable years beginning on or after January 1, 2008, and before January 1, 2014.

“Qualified health insurance” would mean amounts paid on behalf of employees to:

- An HDHP, or
- An HSA.

“Qualified taxpayer” would mean:

- Any small to medium size employer, or
- Any small to medium employer that has not provided health insurance to their employees during the preceding five taxable years.

“Small employer” would mean a person, as defined in Section 7701(a) of the Internal Revenue Code, or a public or private entity, employing at least two but not more than 50 persons.

“Medium employer” would mean a person, as defined in Section 7701(a) of the Internal Revenue Code, or a public or private entity, employing at least 51 but not more than 250 persons.

This bill specifies the following:

- A deduction would not be allowed for the same expenses for which the credit is allowed.
- Any unused credits would be carried over to future years until the credit is exhausted.
- The Franchise Tax Board would provide a report on the usage of the credit to the Legislature, on or before September 1, 2012.
- The Legislative Analyst would provide a report on the effectiveness of the credit to the Legislature, on or before March 1, 2013.

This bill would allow the credit to personal income taxpayers and corporate taxpayers.

IMPLEMENTATION CONSIDERATIONS

This bill specifies that FTB is to provide a report to the Legislature on or before September 1, 2012, on the usage of this credit, but fails to identify the specific information that should be included in the report. To ease implementation of this bill, the author may wish to amend the bill to include specifics to be reported by the department.

TECHNICAL CONSIDERATIONS

The definition of “qualified taxpayer” is broad. As written, this bill would allow the credit for all small to medium employers, regardless of whether they currently provide health insurance for their employees. The author’s office has indicated the intent of this bill is to encourage employers, who currently do not provide health insurance for their employees, to begin doing so. To support the stated author’s intent, Amendments 1 and 2 have been provided. Amendment 3 is provided to correct a technical error.

LEGISLATIVE HISTORY

ABX1 5 (Nakanishi, 2007/2008) is similar to this bill. Differences with ABX1 5 include the following: (1) sunsets in 2013, one year earlier than this bill; (2) has different definitions of a “small employer” and a “medium employer;” (3) includes an employer category titled “new small to medium employer” that is not included in this bill; (4) includes a requirement that employees pay tax to this state (this bill has no comparable requirement); and (5) limits the credit to the first three consecutive taxable years beginning with the taxable year the credit is claimed (this bill has no comparable requirement). This bill is currently at the Assembly desk.

AB 85 (Nakanishi, et al., 2007/2008) is identical to ABX1 5 and failed to pass the Assembly Revenue and Taxation Committee.

SB 151 (Denham, 2007/2008) would allow a credit equal to the amount paid or incurred during the taxable year for qualified health expenses by a qualified employer. This bill failed to pass the Senate Revenue and Taxation Committee.

SB 199 (Harman, et al., 2007/2008) is similar to SBX1 11. This bill would create a tax credit for certain taxpayers that provide qualified health insurance for their employees. This bill failed to pass the Senate Revenue and Taxation Committee.

SB 2737 (Nakanishi), SB 1639 (Dutton), and SB 195 (Maldonado), from the 2005/2006 legislative session, were similar to this bill. These bills failed passage out of the Senate.

AB 1262 (Campbell), AB 1734 (Thomson), and AB 2765 (Knox), from the 1999/2000 legislative sessions, and AB 694 (Corbett) and AB 39 (Thomson/Campbell), from the 2001/2002 sessions, were introduced creating an employer provided health insurance type credit. These bills failed passage out of the Assembly.

OTHER STATES’ INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws. *Illinois, Michigan, Massachusetts, Minnesota, and New York* conform to the federal deduction for contributions to HSAs. *Florida* has not conformed to the new federal HSA provisions for corporate income taxpayers and does not have a personal income tax.

FISCAL IMPACT

Implementing this bill would require changes to existing tax forms and instructions and modifications to the department's information systems, which could be accomplished during the department's normal annual update.

ECONOMIC IMPACT

Revenue Estimate

Revenue Impact of SBX1 11 Enactment Assumed Before January 1, 2008 (\$ in Millions)			
	2007-8	2008-9	2009-10
Revenue Impact	-\$20	-\$90	-\$150

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill. The numbers in the table above have been adjusted to reflect revenue estimates for fiscal years.

Note: The revenue estimates in SB 199 use an annual premium growth rate of 10%. The Employment Development Department revised the growth to 7%. Thus, the revenue estimates above reflect the 7% growth rate starting in fiscal year 2008-2009.

Revenue Discussion

This estimate is based on state employment data, discussion with industry experts, and a survey of literature related to the California health care industry. Using EDD data it is projected that about 6 million employees would be working in qualified small and medium size businesses in 2008. It is assumed that this pool of employees would either, switch from a regular insurance plan to an HDHP, newly enroll in an HDHP, or remain enrolled in an HDHP. For the taxable year 2008 the total employer cost is as follows:

	Total Number of Employees	Average Premium	Employers Cost	Total Employer Cost
Employees only	364,000	\$2,500	88%	\$801 million
Employees and Dependents	182,000	\$5,700	75%	\$780 million
Total Employer Cost for Premiums				\$1.58 billion

The total credit amount would be \$240 million (rounded) for 2008 (15% of \$1.58 billion). Approximately 75% of the credit amount would be absorbed by sufficient tax liability, resulting in approximately \$180 million (75% of \$240 million) in potential credits.

It is anticipated that employers who will switch from a regular health plan to an HDHP will increase the wages of their employees resulting in an additional \$412 million in taxable wages, and a revenue increase of \$21 million (\$412 million x 5% marginal tax rate). Under current law employers are allowed a deduction for wages and health premiums paid for employees resulting in an estimated \$63 million of tax revenue impact under current law. The net revenue impact of this bill for 2008 would be approximately \$96 million (\$180 million in potential credits - \$21 million relating to increase in taxable wages - \$63 million relating to employer deductions foregone in lieu of credits).

POLICY CONCERNS

This bill allows an unlimited carryover period. Consequently, the department would be required to retain the credit on the tax forms indefinitely. Recent credits have been enacted with a carryover period limitation; experience shows credits are typically exhausted within eight years of being earned.

This bill would allow a credit for qualified health insurance paid for employees who perform services in this state, yet, fails to specify a minimum percentage of time or number of days that the employee must perform services in California. Consequently, credits could be given for employees working both inside and outside of California. The author may wish to amend the bill to specify requirements for employees who perform services in this state.

Because California is currently out of conformity with the federal HSA provisions that allow a deduction for contributions to an HSA, this bill would allow a credit for employers who contribute to an HSA, but tax the employee for the amount of such contributions.

LEGISLATIVE STAFF CONTACT

Scott McFarlane
Franchise Tax Board
(916) 845-6075
scott.mcfarlane@ftb.ca.gov

Bagher Modjtahedi
Franchise Tax Board
(916) 845-5243
bagher.modjtahedi@ftb.ca.gov

Brian Putler
Franchise Tax Board
(916) 845-6333
brian.putler@ftb.ca.gov

Analyst	Scott McFarlane
Telephone #	(916) 845-6075
Attorney	Tommy Leung

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SBX1 11
As Introduced October 11, 2007

AMENDMENT 1

On page 2, lines 14 and 15 strikeout "any small to medium size employer, or,"

AMENDMENT 2

On page 3, lines 13 and 14 strikeout "any small to medium size employer, or,"

AMENDMENT 3

On page 3, line 14, after 'medium', add:

'size'